Corporate governance mechanisms and performance of banks: A review

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Abstract
Corporate Governance is an area that has gained increased interest from academic and policy makers around the world in the past two decades, spurred by major corporate scandals and governance problems in a host country consisting of scandals from both developed and developing countries. Research has revealed that governance problem is particularly pronounced in many emerging economies where family control is the predominant form of corporate ownership and where minority rights are often not enforced. Based on our review of related literature, we conclude that adherence to code of corporate governance by directors of Nigerian Banks determines the country's competitive positions. The directors must be free to drive their institutions forward, but must exercise that freedom within a framework of transparency and effective accountability. We thus recommend amongst others that regulatory agencies should be more active to enforce compliance, and impose sanctions where and when necessary.

Keywords: Corporate Governance, Performance, Banks

1. Introduction

Corporate governance refers to the rules, processes or laws by which institutions are operated and governed. It is developed with the primary purpose of promoting a transparent and efficient banking system that will engender the rule of law and encourage division of responsibilities in a professional and objective manner. Effective corporate governance practices provide a structure that works for the benefits of stakeholders by ensuring that the enterprise adheres to accepted ethical standards and best practices, as well as formal laws.

A survey carried out, by the Securities and Exchange Communications (SEC) in April 2003, as quoted by the Central Bank of Nigeria (CBN, 2006 p.2) [18] revealed that only about 40 percent of quoted companies in Nigeria, including banks had as at that date approved operational codes of corporate governance. The same study further affirmed that poor corporate governance was a major factor behind known distresses cases in the nation's financial institutions. A major setback of the SEC code then was that it covered only banks that were quoted on the Nigerian Stock Exchange (NSE,) specially only seven out of the eighty-nine banks existing then. The observed weakness in governance practices by banks as well as emerging cases of infractions of standard corporate governance practices among banks which became manifest after the banking sector consolidation exercise of 2005 made this statement imperative.

To address the above lapses, and other challenges facing the banking sector, the CBN issued the 2006 code of corporate Governance which took effect from April 3, 2006 (CBN, 2006) [18]. Apart from specifying the core elements of corporate governance practices, risk management, and the role of internal and external auditors, despite this comprehensive code of corporate governance for Nigerian Banks, some weakness were still observed in 2009 leading to the distresses of eight banks and necessitating the intervention of the CBN by capital injection of N620 billion (Six thousand and twenty Billion Naira) only, and subsequent take-over.

The take-over, effected in August 14, 2009 was complimented with top management cleansing of the banks through the sack of all the managing directors, and the executive directors of the affected banks and their replacement with CBN appointed directorate management staff.

The gaps in the existing code of corporate governance necessitated the enactment of the 2010 Providential Guidelines by the CBN to strengthen/compliment the provisions in the banks' corporate governance code among other issues (CBN, 2010) [19]. The corporate governance issues covered include; tenure limitations, compensation of executive directors and limitations on eligibility of former top-level staff of the CBN and NDIC to serve in banks.

On July 31, 2012, in a circular to all banks and discount houses, in Nigeria, the Central Bank of Nigeria (CBN) explained its attempt to review the extant code of corporate Governance for Banks in Nigeria. According to the apex bank, the review was intended to strengthen governance practices, eliminate perceived ambiguities in, and align the code with current realities and global best practices. The few studies on bank corporate governance normally focused on a single aspect of governance, such as the role of directors or that of shareholders while omitting other factors and interactions that may be important within the governance framework. Feasible among these studies is the one by Adams and Mehnan (2000) for a sample of US companies where they examined the effect of board size and composition on value. Another weakness in that such study is often limited to the largest, actively traded institutions many of which show little variations in their ownership, management, and board structure and also measure performance as a market value.

In Nigeria, among the few empirically feasible, studies on corporate governance are the studies by Sanda *et al*., (2005) and Ogbechie (2006) [26] that studied the corporate governance mechanisms and firm's performance. In order to address these deficiencies, this study is not restricted to the framework of Organization for Economic Development principle, which is based primarily on shareholders sovereignty. It analyzed the level of compliance of code of corporate governance in Nigerian banks with the Central Bank of Nigeria code of corporate Governance. It is therefore against the forgoing that our paper sought to examine the effects of corporate governance mechanisms on the performance of banks. The subsequent sections of this paper are the review literature, methodology and conclusions

2. Review of Literature

2.1 Corporate Governance Mechanisms

Corporate governance mechanisms are means by which stakeholders can enforce their rights and ensure that their interests align with those of managers. Corporate Governance mechanisms can be also be seen as those policies, guidelines and controls to manage an organization and reduces inefficiencies. Common among these mechanisms as identified by Solomon and Solomon (2002) [29] are: Legal environment and law enforcement, Board of Directors, Executive compensation, large shareholdings' market for corporate governance and corporate disclosure (Solomon *et al*; 2002) [30].

Denis and McConnell, (2003) classified these mechanisms as internal and external mechanisms of Corporate Governance. Luo (2005) in analyzing Corporate Governance in multinationals, however presents three main mechanisms of governance Classified as; market-based culture based and discipline based. However, for the purpose of this study, we will be dealing with the following:

2.1.1 Board of Directors

He main organ for control of governance in Corporations/Banks are the board of Directors which the traditional model is responsible for monitoring managers on behalf of shareholders, ensuring the protection of right and make for shareholder profit maximization. The board achieves this objective by a mixture of direct supervision and delegation of its roles to sub-committees of the board. Two main types of Board of Directors are predominant in the literature of governance, i.e. the single Tier Board as in the UK, USA, Nigeria and the Two Tier Board as practiced in Continental Europe.

Significant research on board structure of corporations had been carried out on the composition, skills and diversity of board membership, executive remuneration, however, a limitation of the board of directors as a mechanism of Corporate governance is the inclusion of the same mangers that it seeks to monitor and control on the board of Directors in other instances, the process of nominating directors of company has created an "Old Boys Network" where directors pay are determined by other directors on whose board remuneration they serve (Cross Directorship).

Similarly, in emerging economies like Nigeria, where external governance mechanism is weaker, boards ability to effectively monitor managers on behalf of shareholders is a fundamental pillar for Corporate Governance. A limiting factor to this is however the concentration and family ownership (la portal *et al*; 1999; Dollas 2011).

2.1.2 Ownership Structure

Ownership structure represents another mechanism of control for corporation. The composition of equity holders and their size of holdings determine an important element of corporate governance as it helps align management objectives with those of shareholders. However, the extent of manager ownership beyond that of aligning interest with shareholders can further serve as an incentive for managers to pursue their own objective contrary to that of the shareholders. However, from a corporate governance research point, the common issues that have been studied in the literature include the role of ownership structure in corporate governance, the relationship between ownership structure and board performance (Shleifer & Vishny, 1999; La Portal *et al*., Mitton 2002).

Although, Corporate Governance mechanism are argued to be a suitable means of holding managers to account, previous research has criticized the extent to which these mechanisms are effective checks on accountability. They are argued as failing to account for the interplay of social and political considerations inherent in the process of formulating and implementing these Codes both at National and Organizational levels. Marnet (2007) argues that Corporate Governance model are incapable of addressing challenges of Corporations as these models ignore social and political behaviors inherent in organizations.

This argument is supported by the view that while corporate governance models may represent appropriate ideals, they fail to address the specific problems that faces organizations as evidenced in their inability to present financial crises or the

spats of frauds in the Banks. Similarly these mechanisms fail to consider local and specific country considerations in their formulation and design. The models assume in most cases the corporation is structured in line with the traditional American model i.e., a traditional system of dispersed ownership as opposed to the more prevalent system of concentrated or family ownership that is more prevalent around the globe (La Portal *et al*., 1999).

2.2 Corporate Governance in Emerging Economies

While Corporate Governance has been widely researched, emphasis has naturally focused on the emerged markets of Europe, America and Asia with less research from emerging markets of Africa, Latin America. To (Dollas, 2022. Less than 1% research on Corporate Governance are related to emerging markets with most of these studies adopting either a comparative study with western system of governance or focus on board and firm performance with corporate governance. There is a need to expand the frontier of Corporate Governance studies as well as examine the unique peculiarities that shape practice of Corporate Governance in emerging economies.

The study of Corporate Governance in Nigeria has an emerging body of literature notable among which are Yahaya, 1998; Okike 2000, 2007; Yakassai, 2001; Adegbite and Nakajima, 2010; Adegbite and Amaeshi, 2010 Adegbite, 2012 [38, 39, 7, 9, 10]. Among these studies common in terms of Codes issues to date, there are the SEC Code of 2003, 2011, CBN mandatory Code of 2006 [18]. (Opara, 2011; Angaya and Gwilliam, 2008). These studies adopt either a Comparative study of governance or an exploratory study of corporate governance practice in the country.

Opera (201) for instance examines barriers to issues and implications at a firm level of corporate governance practices in Nigeria by means of a mixture of qualitative and quantitative data. The study identified common barriers as the protection of minority shareholders, lack of commitment and responsibility of shareholders, regulatory framework, and enforcement mechanisms concentration of ownership, transparency and disclosure. This view mirrors closely that of Oyejide and Sotibo, (2001). The study's population is however drawn from a mixed sample from insurance, manufacturing and banking assuming that these separate industries have similar governance requirements. This does not make the findings applicable to the banking industry as the peculiar nature of banking was not considered by the study. Also the study fails to account for societal and political influence on system of governance in Nigeria as the basic of the questionnaire and interview questions were based on the OECD Corporate Governance assessment framework without consideration for peculiar context of Nigeria. In terms of her governance need and how socio cultural factors influences governance mechanisms.

Adebite and Amaeshi (2010) [7, 9] examined the influence on corporate governance in sub-Saharan Africa with a focus on actor and strategies influencing Corporate Governance practices. They argue that corporate governance practices in Nigeria (as most emerging Economies) is subject to multiple influences of rating agencies, international organizations whose influence determines the models of Corporate Governance to adopt by corporations in emerging markets. They argue using a mixed qualitative research method the predominant adoption of an Angle-Saxon model is a subtle imposition of foreign agencies without consideration for local factors.

The regulation of corporation governance in the context of emerging countries is discussed considering corruption and social economic problems of the countries. Mensah *et al*; (2003) posits that Corporate Governance and accountability are possible solution to the challenges of Corporate corruption in emerging economies. This view however fails to recognize that corporate governance goes beyond the issues of protecting shareholders and regulations of corporation or minimization of frauds in corporations. Wider issues such as satisfaction and participation of labour, customer satisfaction as this focus is rather ignored. Furthermore, it fails to give account of wider context of needs of other stakeholders as postulated by the stakeholder theory, whose interest may be at variance of the shareholders. While the stake-holder theory postulates several parties to which a corporation owes obligations, it however fails to provide a recognition criteria or which interest group is in cases of stakeholder conflicts.

Corporate Governance in Nigeria is significantly influenced by corporate governance regulatory practices borrowed from other jurisdictions notably the UK. Significantly, the SEC Code is similar to the UK Code of governance and the CBN Code of 2006 [18] while also bearing close semblance in form to the US Sarbanes Oxley act as it provides detailed guidance in the requirements of the governance Codes while also advocating the existence of principles (CBN 2014; Adekoya, 2010; Adegbite, 2011) [8].

In terms of those presented to Nigeria by Organizations such as the World Bank and the IMF, these in most cases are a byproduct of negotiations and bilateral agreement aimed at providing Foreign Direct investment (FDI) in the Country. While the extent to which corporate governance adoption has resulted to FDI remains controversial and is contested, Adegbite (2012) [10] posited that those may have been a product of been over hyped and does not tackle the challenges of governance in the Country.

2.3 Banks Corporate Governance

While there has been a series of reforms in Corporate Governance practices in non-financial sector, these reforms may not be applicable to banks given their special nature and the risk they face and pose to the financial/Economic system. Adams & Mehran (2003) suggested that Corporate Governance for banks differ from other industries as a result of the risk they pose to the economy which requires regulators (mainly Central Banks and Deposit Insurance) to put in place standard and rules to make management practices in banks more efficient.

Two school of thoughts have thus emerged regarding the regulation of banks, these are the Proponents for a governance led regulation and those for a profession or market led regulation. Traditionally, the approach to Corporate Governance regulation for banks involves the government regulator relying on statutory authority and standards to promote the interest of shareholders and other stakeholders. The main mechanism used for controlling banks are restriction on connected lending, restriction on holding, legal and prudential guidelines.

2.4 The special Nature of Banks

Banks are considered special as they perform multiple functions in an economy. Traditionally, banks perform the role of financial intermediation and play important role in the

development of economies. Levine (2004) argue that banks exert a "strong impact on economic development of countries". These roles of strong impact is however not sufficient reasons to warrant a different set of Corporate Governance model or principle different from those that presently operate for other sectors and industries.

Caprio and Levine (2002) identified tow attribute of banks that make them special and in need of greater governance as opposed to the governance of conventional corporation these are:

a) Greater opaqueness than other Corporations
b) Greater regulation

Caprio and Levine (2004) argue that both factors account for the inability of conventional mechanisms applicable to public corporations to effectively function for banks. They contend that the greater opaqueness makes it difficult for equity owners to monitor banks.

The roles of banks are of importance in any economy as they provide funds to deficit sectors of the economy, financial intermediation role facilitate payment and exchange and are regarded as the engine room of growth of emerging countries. Banks assume this role in emerging countries which are characterized by weak and underdeveloped capital markets (Hawkins and Turner, 2000; Arun, 2003) hence the inability of the capital market to finance growth results in banks adopting these roles in emerging countries. The level of importance ascribed to banks is also evident in the extent of regulation imposed by regulatory bodies around the world.

Banks in addition to its traditional role of financial intermediation also serve a social function which necessitates the required extent of regulation required in the banking industry. Soludo (2006) indicates that Nigerian Banks account for over 90% of assets in the financial system and significant roles in financing economic developments of Nigeria (Soludo, 2006).

3. Methodology

The research was conducted using desktop-based research, focusing on the analysis of academically reviewed sources that discuss the effect of corporate governance on bank performance. Desktop-based research was chosen because it is one of the most effective ways to evaluate the relationship between corporate governance on bank performance. Other forms of research, such as surveys and focused group interviews, were not used because in order to avoid the choice of using inflexible research design and possible inappropriate questions (Sincero, 2012).

Five steps were used to determine the academic sources used. The first step was to carefully read and review the materials to fully understand the arguments and main points of the work. The second step was to check the credibility of the work to ensure that it was academically reviewed. The third step was to analyze the content of the work to identify the key points and arguments that could be used to develop the research. The fourth step was to compare and contrast the arguments and points with other viewpoints from different researchers. The last step was to critically evaluate the information, identifying the key strengths as well as weaknesses of the work. Using these steps, the information obtained can be used to support our research questions and findings identified.

4. Conclusion/Recommendations

Clarke (2005) suggests the pattern of economic crisis indicates that there is a cyclical trend in financial crisis and regulation. As the global economy recovers from the 2007 to 2010 crisis, this study has highlighted the need for improved governance and regulatory monitoring of banks in emerging markets. Banks play a cardinal role in emerging markets hence there is a need for a separate model of governance to apply as opposed that of conventional public corporation. Similarly, this study has also contributed to the increasing body of literature in corporate governance with a focus on bank corporate governance practices and bank failure.

Corporate Governance is an area that has gained increased interest from academic and policy makers around the world in the past two decades, spurred by major corporate scandals and governance problems in a host country consisting of scandals from both developed and developing countries. Research has revealed that governance problem is particularly pronounced in many emerging economies where family control is the predominant form of corporate ownership and where minority rights are often not enforced.

The problem of developing an appropriate governance culture in Nigerian Banks seems intractable, however, because it involves a mixture of educational exposure, professionalism, skills development as well as morality and proper attitudinal value orientation (Okafor, 2011: 168). Bank directors in Nigeria get elected (or appointed) to the board because of their connections, and or block shareholding. It is rare for banks to invite persons to serve on the boards solely because of their track record of professionalism, integrity and accountability. One hopes that the trend will change as shareholding in banks gets more dispersed and more stakeholders fully understand the essential qualities that predispose a person to render effective services on the board of the banks.

The study concludes that adherence to code of corporate governance by directors of Nigerian Banks determines the country's competitive positions. The directors must be free to drive their institutions forward, but must exercise that freedom within a framework of transparency and effective accountability. The following recommendations were made to strengthen adherence to code of Corporate Governance and highlight the importance of sound corporate governance practice in the Nigerian Banking space.

1. Regulatory agencies should be more active to enforce compliance, and impose sanctions where and when necessary.
2. Banks should adopt self-regulation as a complement to corporate governance codes which should be regarded as minimum benchmark requirements
3. The right of shareholders to determine who serves on their board should be respected. However, the CBN should be proactive in influencing the quality of board and secondly by thoroughly screening board nominees to ensure that only the right candidates are confirmed for appointment into the boards of banks.
4. CBN should supervise the exposure of bank directors to seminars, workshops and conferences in order to ensure their being kept abreast of current development in banking.
5. There must be improved efforts on corporate governance to focus on the value of stock ownership of board members

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